BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
GREAT WESTERN ELECTRO CHEMICAL)
COMPANY)

Appearances:

For Appellant: F. W. La Frentz & Co., Messrs. Bullock, Kellogg & Mitchell, and Messrs. Byrne & Lamson, its Attorneys
For Respondent: Frank L. Guerena, his Attorney

O P I N I O M

This is an appeal pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929) from the action of the Franchise Tax Commissioner in overruling the protest of Great Western Electro Chemical Company to his proposed assessment of an additional tax of $3,185.46 based upon the return of the corporation for the taxable year ended December 31, 1928. The point before us for determination is whether or not the Appellant is entitled to an allocation of some of its income to business done outside of the State of California under Section 10 of the Act.

The pertinent provisions of the law on this point are as follows:

> "If the entire business of the bank or corporation is done within this state, the tax shall be according to or measured by its entire net income; and if the entire business of such bank or corporation is not done within this state, the tax shall be according to or measured by that portion thereof which is derived from business done within this state." (Section 10, Chapter 13, Statutes of 1929).

It is the position of the Commissioner that all of the business of the Appellant has been done in California so that the corporation is not entitled to any allocation of its income, while the Appellant maintains that only a portion of its business is done within this State and that correspondingly it should be permitted to allocate part of its net income to activity outside of California, arriving at a basis for the tax "according to or measured by" its net income.

Great Western Electro Chemical Company was incorporated in 1916 under the laws of this State and is engaged in the business of manufacturing chemical products which it sells to customers both within and without this State. Its report filed

with the Franchise Tax Commissioner reveals that all of its tangible property is located in California and that 99.4% of its payroll was here, Concededly, 47.5% of its sales were within California, but the Appellant urges that the Commissioner erred in regarding the remainder of its business as California activity. The transactions said to have been wrongly classified as business done within this state have been grouped as follows

(a) Sales of merchandise manufactured in California and shipped to customers outside of California upon orders taken by salesmen outside of California,

(b) Sales of merchandise manufactured in California and shipped to customers outside of California upon orders taken by salesmen from an office maintained in the State of Washington.

(c) Sales of merchandise manufactured in California and shipped to customers outside of California upon orders received by mail in California from customers outside of California.

(d) Sales of merchandise manufactured in South America upon orders either taken by salesmen outside of California or received by mail from customers outside of California; such merchandise never being at *any* time in this state.

The record shows that when the Commissioner denied any right of allocation to the Appellant, holding that its entire activity must be regarded as business done within this state, he assigned, in his notice of additional franchise tax proposed to be assessed, the following reason:

> "The corporation which maintains an office or place of business within this state and not elsewhere, is taxable on the basis of all of its net income, as defined in the franchise tax act.' In the absence of evidence in support of a different allocation, the entire net income is attributed to California."

To this the Appellant responds that the right to allocate net income should not depend upon whether *or not* the taxpayer had qualified to do business in other states, nor should it depend upon whether the taxpayer, by its method of doing business, had obligated itself to so qualify in other states, even though *in* fact it had not actually done so, It is conceded that this state may levy a tax upon net income from business arising in part from interstate commerce.if it chooses to do so under the restrictions indicated by the United States' Supreme Court in the case of United States Glue Co. v. Oak Creek, 247 U. S. 321. However, it is contended that the legislative intent in the Act now under consideration is to tax only that portion of the net income which is derived from business done with this state to the exclusion of interstate commer

'and, of course, intrastate commerce elsewhere.

At the outset, we must observe that the test suggested by the Commissioner in his notice of proposed additional assessment is *no* proper method for determining whether or not a corporation is doing all of its business within California. It is conceivable that an artificial person, like a natural person, could do business away from the state of its domicile without establishing an office at the place where such business is done. In fact at the hearing of the appeal it was conceded by the Commissioner that the reason assigned for denying the right to allocation of income to the taxpayer in the Commissioner's notice was *no* actual test of whether or not business was done outside the state, but merely one of the factors to be considered in arriving at an ultimate determination of that point,

Therefore, it devolves upon us in the performance of our duty under Section 25 of the Act to determine from all of the facts before us whether the manner in which the Appellantwas engaged in business was such as to justify the conclusion that all of its business was done "within this state" as that expression is used in Section 10 of the Act, As indicated by the Appellant, this decision requires the ascertainment of the legislative intent in providing for the allocation of income under that section. We find our principal assistance in the interpretation given by the Courts to the language of similar statutes in other states, since the precise point has never been before our California tribunals.

In 1911 the State of Wisconsin passed an income tax law providing among other things:

> "There shall be assessed, levied, collected and paid a tax upon incomes received during the year ending December 31, 1911, * * * (Section 1087ml, Wisconsin Stats. 1911.)
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> "The tax shall be assessed, levied and collected upon all income, not hereinafter exempted, received by every person residing within the state, and by every nonresident of the state upon such income as is derived from sources within the state: * * * Provided, that any person engaged in business within and without the state, shall, with respect to income other than that derived from rentals, stocks, bonds, securities or evidences of indebtedness, be taxed only upon that proportion of such income as is derived from business transacted and property located within the state, which shall be determined in the manner specified in subdivision (e) of section 1770b, as far as applicable".. (Section 1087m2, subd, 3, Wisconsin Stats. 1911).

This statute was before the Supreme Court of Wisconsin for interpretation in 1915 in the case of United States Glue Co v. Oak Creek, 153 N. W. 241. In that case it appeared that the income of the plaintiff corporation was derived from the following sources:

(a) From the manufacture, sale and delivery of goods from its factory in Wisconsin to customers in Wisconsin.

(b) From the manufacture, sale and delivery of goods from its factory in Wisconsin to customers residing outside of Wisconsin.

(c) From the manufacture of goods at the factory in Wisconsin, sent to branch houses outside of the state, and the sale and delivery of such goods from the branch houses to customers residing outside of the state.

(d) From the purchase of goods in the market outside of Wisconsin and shipped from the place of purchase either directly or by way of the plaintiff's plant in Wisconsin to its branch houses, and the sale and delivery of such goods to customers residing outside of Wisconsin.

As stated by the Court:

"The question naturally arises first: What portion of plaintiff's net 'business income' is income 'derived from business transacted and property located within the state,' and subject to the tax upon incomes? * * * * It is well understood that many elements of business, other' than the use of capital *or* the service of employees to perform the necessary labor, enter into the production of an.income in the sense involved in taxation, and that the sources of such income are not absolutely separable, one from the other * * * * The statute is to receive a practical interpretation. * * * *

"The plaintiff, as recipient of its corporate income, whatever its source, has a domicile in this state, and the principal part of its property and its business, which is employed in the transactions out of which the income issues, is located in this state. The statute seeks to tax the part of this income which has its source in this state. The fact that the business so conducted may involve transactions in interstate commerce cannot affect the situs of the income, nor does the fact that goods manufactured at Carrollville (Wisconsin) and sold without this state affect the source of the income; The income so derived is the result of the business carried on at Carrollville in this state, * * * * The manufacture, the management, and the conduct of the business at the home office are the controlling features in the process of disposing of the article produced in the factory and constitute the source out of which the income

> issues and gives it a situs within the state under the income tax law." (153 N. W. 243 and 244)

Only the type of transactions described under classification (d) above was held to be business done without the State of Wisconsin. The Court found that such business was transacted and located without the state, excepting incidental management from and accounting for the result thereof to the corporation's principal office in Wisconsin. The business was not excluded from Wisconsin business because of any element of interstate commerce, but due to the fact that it could not be attributed to the activity of the company within that state.

While the statute under consideration by the Supreme Court of Wisconsin was one imposing a direct income tax rather than a tax "according to or measured by" net income as under the California statute, the analogy is so close that we regard the holding of the court as extremely helpful in arriving at a proper interpretation of our own law.

Clearly, there is no unconstitutional burden on interstate commerce involved in holding that income derived from sales in interstate commerce shall be considered taxable. (United State: Glue Co. v. Oak Creek, 247 U. S. 321; International Elevator Co, v. Thoresen (North Dakota 278 N. W. 192)).

If the 'doctrine of the case of United States Glue Co. v. Oak Greek above cited is applicable to the California statute, and we think it must be, it is apparent that all sales falling in the groups lettered (a) (b) and (c), as designated by Great Western Electro Chemical Company with reference to. its business must be considered California activity for the purposes of determining whether the income of the corporation is wholly taxabl here. It will be recalled that each of these groups was sales in interstate commerce made either through orders taken by salesmen outside of the state or from an office maintained in the State of Washington or upon orders received by mail in California from customers out of the state. The transactions are entirely comparable to those held taxable for Wisconsin purposes in the cases cited.

At the hearing of the appeal, the Commissioner and the Appellant were ordered to file such stipulation as might be mutually agreeable with reference to the treatment and classification of certain interstate business of the Appellant claimed by the latter to have.no connection whatever with its California activity. Presumably, this business would fall in group (d) of the classification made of the Appellant's business [illegible], sales of merchandise manufactured in South America upon orders either taken by salesmen outside of California or received by mail from customers outside of California, such merchandise never at any time being within this state. No stipulation was filed due to the inability of counsel for the Commissioner and the Appellant. to arrive at a common ground. However, the Appellant filed a supplemental memorandum of facts upon which it is indicated that there were some sales made of purchased goods shipped from New York to Oregon and Washington, from Ohio to Utah, from

Michigan to Oregon, from Maryland to Hawaii and from Montana to Hawaii. These transactions were relatively insignificant in comparison with the entire sales of the company for the year, being less than $40,000 out of gross sales of $2,396,000. Moreover, it is not clear whether or not the goods were actually of the type described in group (d) viz., merchandise manufactured in South America upon orders taken by salesmen outside of California or received by mail from customers outside of this state.

In view of the uncertainty on these points 2nd the relative unimportance of the transactions, we should not feel warranted in reversing the conclusion of the Commissioner that the Appellant is not entitled to allocate any of its income to business done outside of California. Certainly we are of the view that the Appellant is not entitled to the percentage of allocation of income without the state for which it asked and if perchance its accounting records should reveal *some* income of the ytpe deemed non-taxable under the Wisconsin decision above cited, that circumstance has not been brought to our attention in sufficient definiteness to warrant a recalculation of the tax. Therefore, we conclude that the action of th Commissioner in assigning all of the income of the Appellant to California business was justified and should be upheld.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, that the action of the Franchise Tax Commissioner *in* overruling the protest of Great Western Electro Chemical Company, a corporation, against proposed assessment of an additional tax in the amount of $3,185.46 based upon the return of said corporation for the year ended December 31, 1928, pursuant to Chapter 13, Statutes of 1929, be and the same is hereby sustained.

Done at Sacramento, California, this 14th day of December, 1931, by the State Board of Equalization.

Jno. C. Corbett, Chairman
R. E. Collins, Member
H. G. Cattell, Member
Fred E. Stewart, Member

ATTEST: Dixwell L. Pierce, Secretary